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## NOTES AND MEMORANDA.

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### THE FRANCHISE TAX LAW IN NEW YORK.

Much interest has been manifested throughout the country in the passage of the recent franchise tax law in New York. This interest is partly due to the effective manner in which Governor Roosevelt forced the passage of the bill. Up to the last moment the vote on the original Ford Franchise Bill was in doubt, and would have remained so but for the emergency message sent to the legislature in its closing hours. Further consideration, however, convinced the governor of the advisability of certain amendments to the bill; and a special session of the legislature was summoned for this purpose. Practically no other business was transacted; and here, again, it was the clearly expressed determination of the governor to sign the original bill unless the amendments were adopted, which whipped into line the Republican majority and brought about the final passage of the law as it now stands.

Readers of this Journal need not be informed as to the nature of franchise taxation. The whole conception is a legal rather than an economic one, and its recent growth in the United States is due largely to the prevalent system of the general property tax. In Europe there is no such problem as the taxation of corporate franchises, because corporations are subject either to the general income tax, as in England, Germany, and Italy, or to the special business tax, as in France. Under our American system, however, corporations have usually been liable to the general property tax. The tangible corporate property has always been reached, but the intangible property has thus far escaped the scrutiny of the assessor with almost as much success as has the intangible property of individuals. When taxation is confined to realty and tangible personalty, it evidently becomes necessary, in order to reach the actual value of the property of the corporation,

to add to the tangible property something else representing its capitalized earning capacity. This something else is what is ordinarily termed the franchise,—the privilege accorded by the government to the corporation to carry on the business. The tax imposed on this privilege, known as the franchise tax, is therefore supplementary to the tax upon tangible property.

The idea of a franchise tax in this sense is not altogether new to New York State. For some time New York, like Pennsylvania and other States, has had a system of franchise taxes on corporations for State purposes. These taxes have been levied upon the capital stock in accordance with the amount of dividends paid, or they have been assessed in a certain proportion to gross earnings. The system in New York, however, differs from that in Pennsylvania and in several other States, in that the taxation of corporations for local purposes is still carried on under an old law which, handed down from earlier times, has remained intact for almost half a century. Corporations are liable for local purposes on their general property. That is to say, not only the real estate, but all the personalty, tangible and intangible, of corporations, is locally taxable. The local assessors, following time-honored practice, place an arbitrary valuation upon the capital stock, from which is deducted the value of the realty. The present franchise tax law is partly the result of a recent unsuccessful endeavor on the part of the Brooklyn assessors to increase the assessment of a local corporation. The assessors in this case, when they made up their valuation upon the capital stock, increased it substantially on the ground that the property had become more valuable because of the augmented value of the franchise. The court, however, held that the value of the franchise ought not to be considered in estimating the value of the taxable personalty. Since debts are deductible from personalty in New York, the corporation in question was able to deduct its entire bonded indebtedness from the value of the stock; and it might well happen that, where the bonded indebtedness exceeded the capital stock, a corporation would be taxable on its real estate only. It was partly to remedy this condition of affairs that the franchise tax bill was introduced.

The new act does not apply to all franchises or to all corporations; and the tax system in New York, as now amended, differs from that of many other States. No less than three kinds of corporate franchises are at present taxable in New York. The first is the general privilege extended by the government to become a corporation. For this privilege payment is made in the so-called incorporation fees, known under various names throughout the country. The second kind of "franchise," taxable for all corporations in New York, is the privilege to carry on the business. To use the words of a recent decision of the United States Supreme Court, it is a franchise to do, and not a franchise to be. Most of the so-called franchise taxes in the various commonwealths deal with this kind of a franchise. The new New York law, however, is intended to reach a third kind of franchise,—namely, the privilege conferred upon certain special corporations to make use of city streets and public places. This is manifestly a valuable privilege over and above the other privileges granted by the government. Legally, it may be conferred by the State; yet from the economic point of view it is a privilege granted by the locality. It is only to corporations possessing this particular privilege that the new law applies, and hence the franchises of such corporations are spoken of in the law as "special franchises." The statute prescribes that in estimating the value of property there shall be included "the value of all franchises, rights, authority, or permission to construct, maintain, or operate in, under, above, upon, or through any streets, highways, or public places any mains, pipes, conduits or wires, with the appurtenances for conducting water, steam, heat, light, power, telegraph, telephone, or other purposes." Taxable property shall also include "all bridges, all telegraph lines, wires, poles, and appurtenances, all supports and enclosures for electrical conductors and other appurtenances upon, above, and under ground; all surface, underground, or elevated railroads, including the value of all franchises, rights, or permission to construct, maintain, or operate the same in, under, above, on, or through streets, highways, or public places." The same section goes on to say that "a franchise, right, authority, or permission specified in this subdivision shall, for the purposes of taxation,

be known as a special franchise." Finally, the act adds that "a special franchise shall be deemed to include the value of the tangible property of a person, copartnership, association, or corporation situated in, upon, under, or above any street, highway, public place or public way, in connection with a special franchise. The tangible property so included shall be taxed as a part of the special franchise."

Several considerations present themselves to our notice. In the first place, all the passages of the law quoted above are simply amendments of or additions to the general tax law which prescribes the assessment of real estate. The words "real estate" as used in the tax law are deemed to include the value of all such special franchises. It may of course be questioned whether the law is correct in classing a franchise as real estate. The objection, however, is in the main purely theoretical. From the abstract point of view it is immaterial whether we class such a franchise as personalty or as real estate. It is both, and it is neither. The real estate of a corporation is made valuable by the existence of the franchise in the same way that the personalty of the same corporation is made valuable by the existence of the franchise. The franchise might therefore be classed either as real or as personal property. The practical reasons, however, why the law declares such a franchise to be real estate lie on the surface. Under the New York system, as has already been pointed out, it is impossible to assess the franchise as personalty. Furthermore, even if it were assessed as personalty, there would always be a deduction for bonded indebtedness; and heavily bonded corporations would thus escape taxation. In the case of real estate, on the other hand, no such deduction is allowed. It was therefore to meet the special complications of the New York statute that the special franchises have been made assessable as real estate. In many other States bonded indebtedness is not deductible from personalty, and there franchises might as well be declared to be personal property. In other States, again, mortgage debts are deductible from the value of the realty, while ordinary debts are not deductible from personalty. In such cases an effective levy could hardly be secured unless the franchise were classed as personal property. The

classification of special franchises as real estate, it must be repeated, is a peculiarity referable to that feature in the New York tax system which permits deduction of debt from personalty but not from realty.

The last clause in the section of the law quoted above needs a slight explanation. It was inserted to meet the special case of the gas companies or electric lighting companies which have pipes or conduits under ground and whose pipes or conduits are now already taxed as real estate. As pieces of old clay or metal, these pipes or conduits are of very little value. It was feared that injustice might be done to such corporations by adding the value of the franchise to the present assessment of the pipes, which derive their taxable value largely from the existence of the franchise. It was therefore deemed wise to provide that the value of the pipes should be included in that of the franchise.

Another important section of the law provides for deductions. Many corporations, under the legislation previously in force, are already paying in various ways considerable sums as franchise taxes. If the object of the new law was to make all corporations assume their fair share of the public burdens, it became necessary at the very outset to provide for the avoidance of double taxation. Some of the corporations in question already pay, for instance, a share of their gross earnings to the localities in which they happen to be situated. The value of a franchise, however, must depend upon the present and prospective earning capacity. To tax both the franchise and the gross earnings would, therefore, clearly constitute double taxation. It was hence provided that, when a corporation "has already paid to the locality any percentage of gross earnings or any other income or any license fee or any sum of money on account of such special franchise," the amount so paid shall be deducted from the tax on the special franchise. Certain charges, however, are not in the nature of taxes, but are to be included under what are technically known in public finance as fees or special assessments. Under this head would properly come moneys spent for paving or repairing of pavements. Such charges as these the new law specifically excepts from the deductions permitted from the franchise tax, just as in

the case of private individuals an exemption from taxation is held not to include an exemption from special assessment.

Among the most important features of the law is the provision for the assessment of the special franchise by a State Board. It was deemed wise to place the assessment in the hands of the State Board in order to secure greater uniformity in the method of assessment. There is, moreover, manifestly far less probability of secret arrangements with the corporations than would be the case if the assessment were left to the local assessors. It was this provision of the law which encountered the chief opposition in the Assembly. The Democratic members, representing the interests of Tammany Hall, voted almost to a man against the bill for this reason. Rather than create a new body for this purpose, the whole matter has been put in the hands of the present State Board of Tax Commissioners. The duties of this Board have hitherto been simply to equalize the county assessments throughout the State. The new functions devolving upon them will make the Board one of far greater importance.

It is evident that the success or failure of the law depends upon the action of the State Board. It was considered best not to provide in the bill for hard and fast rules in the method of assessment. This was done in order to give the Board ample opportunity to learn by experience what would be the most practicable and the most equitable plan to pursue. There is every reason to hope that with the exercise of intelligence and prudence the State Board will be able not only to lay down uniform rules of assessment, but also to place upon the special franchise in any particular locality a value which is fairly equivalent to that put upon other tangible realty. It must be remembered that real estate in the cities of New York is assessed at rates all the way from fifty to seventy-five per cent. of the actual selling value. It is obvious that, if the special franchises of the corporations involved are assessed at their full value, there will be an unreasonable discrimination against the corporations. The suggestion was even made in the preparation of the bill that a clause be inserted providing that the franchises in question should not be assessed at a higher rate than other real estate in the locality. It was

clear, however, that such a provision would be self-stultification. The assessors are now required by law to take an oath that they will assess all real estate at its full market value, and the law cannot recognize the existence of a practice which is in direct violation of its own mandate.

Regarded as a whole, the new law may be said to mark a distinct advance in the tax system of New York. It will make those wealthy corporations which have thus far escaped payment of adequate and just taxes pay for the valuable local franchises which they possess. The assertion that the law will impose a burden upon the poorer and less powerful corporations is unfounded, since, to the extent that the corporations are unsuccessful, their franchises are so much less valuable and taxable accordingly. The change is to be commended if for no other reason than that under its detailed provisions we shall finally know what the corporations are actually paying in taxes. The revelation will, no doubt, surprise both the upholders and the opponents of the law. On the one hand, it will be discovered that many corporations pay in taxes far more than the general public suspects; and, on the other hand, it will be interesting to learn that a large number of the corporations are paying less in proportion to the actual value of their property than their rivals. The object of the present law has been declared by its framers and by the governor to be not the taxation of certain corporations more than others, or of corporate property in general more than other property, but the taxation of every one and of all property alike. The special franchise which forms the subject of the tax increases the earning capacity of the corporation, and renders its property valuable. Considered from this point of view, the new law is a step in the direction of equality of taxation,—how great a step must depend very largely upon the action of the State Board of Tax Commissioners.

There remains one final word of comment. In the consideration of the bill in committee and in the House it was recognized that the whole measure is in a certain sense a clumsy one, but necessarily so because of the existing system of taxation in New York. More and more the legislators are awakening to the fact that the present scheme of the general property

tax requires amendment. It is significant evidence of the growing appreciation of the need for even wider changes that a legislative committee from both Houses was appointed, to sit during the recess and to prepare a general plan of reform; and it is gratifying to note that in this committee are to be found some of the ablest members of the legislature, who not only were the foremost in the passage of the franchise tax law, but are also thoroughly aware of the necessity of a reconstruction of the entire system of taxation.

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